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Industrial development policy: concepts and experience

Note by the Secretary-General

In accordance with General Assembly resolution 51/70 of 15 December 1996, the Secretary-General has the honour to transmit to the Assembly the report of the Director-General of the United Nations Industrial Development Organization, in which industrial strategy and policy issues in developing countries and countries with economies in transition are reviewed.

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Industrial development policy: concepts and experience

Report submitted by the Director-General of the United Nations Industrial Development Organization

Summary

The present report, which is presented in response to General Assembly resolution 51/170 of 16 December 1996 reviews industrial strategy and policy issues in developing countries and countries with economies in transition. It analyses the implications of economic globalization for policies aimed at promoting sustainable industrial development, draws conclusions and lessons from a range of country-specific experience and presents an agenda for future multilateral cooperation in this field.

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I GLOBALIZATION AND COMPETITIVENESS: THE CHALLENGE TO INDUSTRIAL POLICY MAKERS

A. INTRODUCTION

1. It is increasingly coming to be recognized that development is a multi-dimensional process, encompassing economic growth, social progress and environmental sustainability. Recent experience in the developing world has shown, for example, that economic growth need not necessarily take place at the expense of equity - a long held assumption. Indeed, poverty and the lack of health and education are detrimental to development, and the ultimate objective of development must comprise the promotion of sustainable livelihoods through employment creation and income generation.

2. Similarly, the stepwise approach calling for a progression from "first stage" macroeconomic reforms to "second stage" social, institutional and legal reforms is also coming under increasingly critical scrutiny. The weakness of this approach is exemplified by the privatization of state enterprises or the liberalization of capital and trade flows. When these take place without commensurate regulatory and institutional reforms, abuses and inequities at the expense of the population at large may follow, thus undermining the sustainability of economic reform processes.

3. Several other important generic lessons have been learnt in this context. They include the realization that:

- high investment, particularly investment in people, is a necessary condition for rapid development;
- markets have an important role to play in resource allocation - provided that they work properly or are appropriately complemented by the state when they do not;
- good public governance, including a stable policy regime, a focused public sector and an effective legal and judicial system are necessary conditions for an open and competitive economy to enjoy sustainable development;
- openness and competition need to be coupled with institutional capacity building and investment in technological, organizational and managerial training in order to be effective in promoting the acquisition of knowledge and innovation; and
- spreading the benefits of enhanced industrial efficiency is essential for the social sustainability of economic development.

4. The history of the past few decades has also shown that despite unprecedented rates of economic and social development, the regional spread of this development has been highly uneven, leading to growing inequalities between and within developing countries and countries with economies in transition. Thus, while a person born in the developing world in the mid-1990s should enjoy ten additional years of life and a 50 per cent higher annual income than a person born 20 years earlier, this average conceals marked regional differences. In East Asia real per capita incomes increased by 400 per cent, while in sub-Saharan Africa they actually fell.

5. While these regional divergences have a wide variety of causes, the development policies and strategies pursued by the respective governments have been an important determinant. Given the dominant role in overall economic and social development played by industry through its

contribution to productivity growth, technological dynamism, manpower training, intersectoral linkages and exports, it is also obvious that differences in policies and strategies addressed to industrial development have been particularly important sources of the observed regional disparities in development patterns.

6. The formulation and implementation of national industrial strategies and policies is becoming increasingly complex, however, as the process of globalization results in external influences becoming progressively more important determinants of industrial development at the national level, even in huge sub-continental countries such as China and India. The spur of competition in the world marketplace, technological progress and international economic integration are gaining increased influence as drivers of economic and social change. Industrialization is thus increasingly becoming a local dimension of a global process of shifting comparative advantages. With the internationalization of industry offering important new opportunities to developing and transition economies to participate in cross-border production networks and partnerships, national industrial strategies and policies are increasingly serving to define the multiple and complex bonds between domestic development needs and world economic integration.

B. ECONOMIC DISPARITIES

7. Differences in economic and industrial growth rates across countries and regions are readily observable at scales ranging from double-digit growth to subdued and even negative growth rates. Economic and industrial growth disparities have been more pronounced within than among major

regions of the world. Each developing region has a small contingent of industrially fast growing countries while the vast majority has been falling behind.

8. The data in Table I.1 reveal the highly skewed pace of global economic and industrial expansion. Growth was most rapid in South and East Asia during 1985-1995, with MVA and GDP growing at average annual rates of 9.2 per cent and 6.9 per cent, respectively. A number of countries within this region emerged as first and second generations of newly industrializing countries (NICs), using manufacturing as the principal propellant of economic progress. Foreign trade and increased interaction with the global economy were the major sources of growth in these economies. In stark contrast, growth remained subdued or even negative in some countries of the region. A number of recent good performers on the regional growth league table are likely to be affected by the East Asian financial crisis, but a few countries, including China, appear likely to be able to weather the effects of the crisis.

9. Strong industrial growth of more than 5.5 per cent per year in Latin America in the 1960s and 1970s could not be sustained in the 1980s and 1990s. However, the regional average growth rate understates the good performance of a few countries of the region. The region as a whole recorded 1.6 per cent and 2.6 per cent growth rates of MVA and GDP, respectively, between 1985 and 1995, while a number of countries in the region were able to generate a rate of MVA growth exceeding 5 per cent per annum. Nine countries in the region experienced negative rates of MVA growth , however, with this trend being particularly pronounced in countries which failed to integrate into the world economy.

Table I.1 Average annual growth of MVA and GDP by region, 1985-1995

(Percentage change in constant 1990 prices, unless otherwise specified)

Region	MVA	GDP	MVA per capita (in constant 1990 US dollars)	GDP per capita
Africa	0.9	2.2	67	630
Latin America	1.6	2.6	591	2,863
West Asia	3.8	1.8	495	3,180
South and East Asia	9.2	6.9	236	834
All developing countries	5.8	4.5	258	1,109
Least developed countries	0.6	1.0	29	334

Source: UNIDO database.

10. West Asia's average annual rate of MVA growth from 1985 to 1995 stood at 3.8 per cent. The fastest growth rate was recorded by Kuwait at 14.7 per cent per annum. Oman, Saudi Arabia, Bahrain, and Turkey recorded rates of MVA growth exceeding 5 per cent per annum.

11. Despite a subdued average MVA growth rate of 0.9 per cent during 1985-1995 in Africa, several countries in the region emerged with impressive rates of MVA growth. Uganda recorded a 10.3 per cent average annual MVA growth rate, followed by Swaziland with 9.5 per cent, Lesotho with 8.6 per cent, Botswana with 8.4 per cent, Guinea with 7.5 per cent, and Mauritius with 7.3 per cent. Negative growth rates were experienced by fifteen countries in the region, however, which pulled the regional average down to less than 1 per cent.

12. Global industrial growth has thus been an uneven process. Inequalities between countries within regions have widened. In the case of Africa, which includes the largest number of late-comers to the industrialization process, the opening up of international financial and commodity markets has not yet had a significant impact on the pace of industrial development. It is contended that the fastest-growing countries have been those that have managed to industrialize by developing a comparative advantage in manufactured exports to the point where they have become the engine of growth.[1] This pattern of growth, characterized by a growing share of manufacturing value added in GDP and a rising ratio of manufactured exports in total exports, marks the first phase of the integration of developing countries into the global economy. Some countries in developing regions have benefitted far more from the globalization process than others. The challenge for the next decade is to achieve some degree of global integration in terms of exports and foreign direct investment.

13. With an MVA per capita of just $29 the least developed countries (LDCs) are at a serious disadvantage. In a number of LDCs, industrial growth remains constrained by low levels of

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1 UNIDO, *The Globalization of Industry: Implications for Developing Countries Beyond 2000*, December 1996.

demand due to the lack of purchasing power. While LDCs as a group registered an annual average rate of GDP growth of just 1 per cent and an MVA growth rate of less than 1 per cent between 1985 and 1995, some individual LDCs recorded a much better performance. Double-digit growth rates were achieved by four LDCs, while five others recorded rates of MVA growth of more than 5 per cent. As a number of LDCs have revealed their potential to grow and even leapfrog other countries, factor productivity has risen in the 1990s and gross returns on investment have been relatively high. Agro-processing industries - especially food manufacturing and textiles - dominate the industrial structure of both African and Asian LDCs. Manufactured export performance has been particularly impressive in garments and agro-related products - especially fish - in some African LDCs. However, the hard reality is that manufacturing growth remains concentrated in a few LDCs.

14. Despite a high degree of sophistication and technical progress in a number of manufacturing activities in the world, low wage-costs remain the key determinant of competitiveness in the mass production of standardized products. LDCs could thus benefit initially from their low wage-cost advantage as the constant redeployment of labour-intensive operations to cheap locations continues. The experience of recent years has shown that LDCs which seize this opportunity through the creation of an enabling environment will emerge as major beneficiaries of global industrial growth.

C. THE ROLE OF INDUSTRIAL DEVELOPMENT POLICIES AND STRATEGIES

15. The role of industrial development policy in open, market-driven developing and transition economies led by private investment has been subject to intense debate since the mid-1980s. Biases in this debate have at times diverted attention from matters critical to the development prospects of developing countries and transition economies.

16. While industrial development is concerned with productivity growth, sustainable resource mobilization, capacity-building and technological progress, much of the policy controversy of the past decade has focused on dismantling short-term measures that encourage rent-seeking through subsidies, import controls, credit allocations and the like. By inducing perverse incentive regimes and the entrenchment of vested interests, import-substitution and inward-looking policies were largely responsible for favouring rent-seeking at the expense of efficiency gains and competitiveness. Although these policies played a role in building the industrial infrastructure and capabilities required for successful export-oriented manufacturing in today's more open and market-driven developing and transition economies, they are generally accepted to have become dysfunctional and exhausted their life cycle.

17. At the same time, however, industrial policies and strategies have a key developmental role to play in addressing multiple market failures due to market imperfections and ill-developed or missing markets - particularly those for capital and technology. Industrial development is fundamentally concerned with the slow, long-term, incremental acquisition of technological, organizational and managerial skills and capabilities required to attain world standards in the production of goods and services. This involves complex microeconomic and institutional transformations that markets alone, left to their own devices, cannot accomplish, even with the right macroeconomic fundamentals. To succeed in the challenging task of promoting industrial development, it is therefore not enough merely to fill gaps between other policies in such areas as macroeconomics, education, institutional development, and environmental, regional and social matters in an *ad hoc* manner. These policies need to be integrated with specific industrial

development policies in the clear recognition that these various sets of policies do not substitute but complement one another.

18. A failure to heed these policy-related maxims can lead to serious problems in implementing macroeconomic stabilization and reform programmes in the developing countries and economies in transition. By assuming swift market responses to changes in the incentive system in often undeveloped markets, the expected success of such programmes has frequently been overestimated, leading to costly distortions and ineffectiveness in policy implementation.

D. THE REPLICABILITY OF POLICY EXPERIENCES

19. Recent experience underscores two key general lessons on the replicability of policy experiences between countries and regions, both of which relate to the multiple dimensions of development:

- Catching up through leapfrogging may be possible from time to time in selected areas, but is not viable as a general prescription, except at the cost of painful reversals and shocks in expectations. The time it takes to attain substantial economic and social progress may be somewhat compressed by supplementing domestic effort with policy lessons drawn from the experiences of other countries, but there are no short cuts or quick fixes.

- Flows of experience are not unidirectional but move in all directions: from North to South and South to North and from East to West and West to East. With globalization, learning in policy making increasingly relies on a global pool of experience which all countries share and on which all of them need to draw. Although such a pool should constitute an international public good, developing and transition economies are handicapped by asymmetries and imperfections in the market for information which tilt the global playing field.

20. Recent experience has also shown that promoting competitive markets is not as simple as conventionally perceived. Opening up the economy, deregulating and privatizing are necessary, but far from sufficient, to attain a working market-driven economy. A clear understanding is also required of how to deal with non-performing markets, and of the relationships between markets, institutions and the state, as well as the structure of incentives that govern the implementation of public policy. There is still some way to go before such an understanding can be taken for granted.

E. TOWARDS A NEW SCENARIO

21. The lessons learned from the development experience of the past few decades and the changing global economic environment are giving rise to a new understanding of the role and replicability of industrial development policies and strategies in the industrial development process. This is affected by four key issues, which will be discussed in detail in the following sections:

- policy convergence;
- global norms and standards;
- volatility of international capital flows; and
- domestic responses.

Policy Convergence

22. Globalization has put the issue of international convergence of policies and institutions at the top of the world's economic agenda, leading to an inexorable spread of universal standards and practices - along with the ensuing economic, social and environmental consequences. The extent of this trend is indicated by the fact that 109 developing countries and countries with economies in transition have launched major market-oriented reform programmes since 1980 - 75 of them since 1989. At the same time, 104 of the 131 members of the World Trade Organization are developing countries and countries with economies in transition, while another 28, including Taiwan Province of China and the Russian Federation, are seeking their entry under special conditions.

23. These pressures towards policy convergence notwithstanding, the fundamental question remains as to the extent to which universal best practice rules can be uniformly, costlessly and swiftly enforced by all countries, regardless of their stage of development and national conditions. This question is particularly relevant in view of growing differentiation experienced by the developing world in recent decades, which has created divergent policy challenges which determine the scope for emulating development successes across borders. Table I.2, which groups developing countries and countries with economies in transition into four categories according to their various stages of development, illustrates the diversity of these policy challenges.

Table I.2. Policy challenges for industrial development faced by various country categories

Country category	Key policy challenges
Newly opened economies (a)	To couple the increasing global integration of the economy with the creation and sustainability of the manufacturing sector's competitiveness
Newly industrializing economies	To renew manufacturing competitiveness and offset declining rates of return on investment by increasing efficiency
Economies in transition	To redefine the role of the state, establish a market system, restructure industry, modernize management systems and close important structural adjustment gaps
Least developed countries	To promote reforms aimed at enhancing domestic supply responses through structural change, resource accumulation and the creation of institutional capacities and appropriate incentive systems

(a): Countries formerly pursuing inward-oriented industrialization strategies, eg. Argentina, Brazil and India.

Global Norms and Standards

24. The globalization process is also leading to the emergence of global standards, both directly through interactions with global markets and institutions and indirectly through the broadening and deepening of regional integration processes. Specifically, increasing exposure to international competition causes national policies to be increasingly influenced by the external environment, and raises the pressure on them to comply with international norms. In many cases, national systems are being required to adjust to international protocols and conventions and voluntary agreements in a growing range of areas encompassing governance, environment, trade, finance, investment, labor and technical standards as indicated in Box I.1.

25. The quality of the political, social and business institutions around which industrial activity is organized is increasingly being judged in international fora in terms of the extent of their adherence to such norms. It may also be noted in this context that voluntary standards tend to become binding over time. For example, ISO standards are not obligatory, but they are a *de facto* requisite to enter many advanced country markets.

26. Well-tuned, modern and effective domestic regulatory and incentive regimes are required to respond positively to these challenges. The accommodation to global change requires structural and administrative reform in many areas of public management through major investment in people and the acquisition of knowledge. The ensuing adjustment costs may be mitigated through the search for joint solutions to policy problems that governments cannot solve alone, eg. in the fields of environmental protection or the regulation of global financial markets.

Box I.1 Examples of Binding and Voluntary Global Covenants in the Fields of Trade, Investment, Technical Standards, Environment and Finance

- *Trade, Investment and Technical Standards*

  WTO Agreements on TRIMs, TRIPs, GATS, antidumping, technical barriers to trade, rules of origin, government procurement

  OECD Multilateral Agreement on Investment

  ISO 9000

- *Environment*

  Montreal Protocol (CFCs)

  Kyoto Protocol (greenhouse effects)

  Basle Convention (hazardous wastes)

  ISO 14000

  World Bank voluntary guidelines

  Chemical industry voluntary guidelines (Responsible Care)

  European Union Eco-Management and Audit Scheme

- *Finance and Corporate Governance*

  System of multilateral surveillance of national financial, supervisory and regulatory systems, encompassing banking and securities

  Special Data Dissemination Standards, Code of Good Practices on Fiscal Transparency and Code of Goods Practices on Financial and Monetary Policy established by the IMF

  Prudential regulation and standards

  Standards to monitor adequacy of foreign currency liquidity

  Basle Core Principles on Effective Banking Supervision

  Standards and guidelines on corporate governance

  International standards for accounting, disclosure and auditing practices in the corporate sector

Volatility of International Capital Flows

27. The East Asian financial crisis of 1997-1998 has raised a number of new questions regarding the economic and industrial development process as a group of countries that had experienced rapid development for decades, and had often been presented as an example for the rest of the developing world, suddenly suffered a severe setback. While there is growing consensus that

these events were due to a mix of home-grown and exogenous causes, it is also undeniable that the volatility of international capital flows played the dominant role in triggering the crisis. A sudden shift in market sentiment and speculative attacks on local currencies in the region, reinforced by the contagion effect as the focus of these attacks shifted from one country to another, has resulted in a sharp devaluation of many currencies. This, in turn, has raised the cost of imported inputs and of servicing offshore corporate debt, driving many local industrial enterprises into bankruptcy.

28. The problem is not just the sheer amount of itinerant global capital involved - some US$ 25-30 trillion including bank lending, securities issues, and exchange-traded and over-the-counter (OTC) derivatives, with amounts traded in world foreign exchange markets in one single day often exceeding total world foreign exchange reserves. The key concern is the composition of global capital movements. These have experienced a complete reversal over the past three decades. In the early 1970s, nine of every ten dollars negotiated in world foreign exchange markets went to the financing of trade and long-term investment, and the remainder to short-term capital movements. By the mid-1990s, the proportion was exactly the opposite.

29. These market characteristics go hand in hand with herd-like behavior, moral hazard, proneness to panic and overshooting, and inadequate risk assessment. Their combined effect is a high degree of volatility leading to sometimes violent swings in market sentiment and economic crises with a highly skewed impact. Developing countries and countries with economies in transition are particularly susceptible to such sudden shifts in the markets, which can seriously undermine their efforts to achieve stability, economic reform and social equity. In its present shape, the international capital market makes the private risk of investing in a country smaller than

the social risk. This is particularly the case for short-term speculative capital flows. Although essential for trade credits, they bring none of the core benefits of foreign direct investment, such as managerial and organizational skills, technical know-how, resource development and market access.

30. As a result, developing countries and countries with economies in transition have become more, rather than less, vulnerable to the vagaries of international capital flows. Bond issues and loan commitments to East Asia, South Asia and Latin America fell by more than half in the fourth quarter of 1997 alone. The swing between capital inflows and outflows in East Asian countries between 1996 and the first quarter of 1998 amounted to more than 11 per cent of their combined GDP, while the swing in Latin America (Brazil, Argentina and Mexico) between 1981 inflows and 1983 outflows was 8 per cent of GDP.

31. The lack of proportion between the size of investors (pension and hedge funds, security firms, banks) and that of recipient domestic economies is another reason for concern. Marginal portfolio adjustment by investors may mean a major event for the host country. A recent report by the Bank for International Settlements has thus shown that a shift of 1 per cent of equity holdings by institutional investors from advanced countries away from domestic equities would represent slightly more than 1 per cent share of total market capitalization in 1995 as opposed to 27 per cent in emerging Asian economies and over 66 per cent of Latin American equity markets.[2] No amount of foreign exchange reserves and macroeconomic fine-tuning would be able to offset the

[2] (Bank for International Settlements, 68th Annual Report, Basle 1998)

disruptive effect of such speculative capital movements in developing countries or countries with economies in transition.

Domestic Responses

32. The effects of globalization on economic and industrial development at the national and local level are varied and complex. Transnational corporate managers often make decisions that vitally affect local areas when they establish investment projects in developing countries or countries with economies in transition. Minimizing the stresses on national and local development and maximizing the potential benefits from the continued internationalization of production must be the main priority of national industrial development policies and strategies.

33. In responding to the pressures generated by the growing exposure of domestic industry to increased competition at home and abroad, such policies and strategies need to focus, in particular, on the creation of an infrastructure conducive to the diffusion of:

- best practices in the entrepreneurial, managerial and technical fields;
- decentralized, flexible and effective mechanisms to promote new industrial enterprises; and
- measures to speed up responses to market needs.

34. An important mechanism for the achievement of such diffusion is the promotion of spatial clusters, which can help to drive local industrial development through the pooling of skills, the creation of efficient markets for inputs and services related to the industry in question, and the

concentration of relevant technical and marketing knowledge and information. Such competitive clusters, comprising specialized small and medium-sized enterprises (SMEs) or even micro-enterprises, often form the backbone of local industrial systems, both in cutting-edge activities and in traditional industries such as garments, textiles, shoes, ceramics and woodworking. Their importance as a means of generating entrepreneurial activities and securing sustainable livelihoods in rural and disadvantaged areas is discussed in further detail in Chapter II.

35. Since interregional and international economic links are increasingly being influenced by trade liberalization and growing factor mobility across borders, national industrial development policies should also seek to promote sub-regional institutions aimed at balancing co-operation and competition among firms and creating an environment propitious to entrepreneurial development. The growth triangles in Southeast Asia, consisting of cross-border clusters of manufacturing, service and technological skills and capabilities, are a good illustration. Developed countries also offer many examples, such as the integration of Canadian industry with the United States manufacturing belt and the manufacturing triangle formed by the Ruhr region in Germany, Northern France and Belgium.

36. In addition, national industrial development policies and strategies should seek to tap the reservoirs of competitiveness arising from patterns of local specialization rooted in history, culture and traditions, as well as those based on natural differences in resources and productivity. Local development based on traditional craft districts, which pool skills in craft production preserved in ethnic and secluded communities for centuries, provides a good example. Such skills are traded within families and communities from generation to generation within specific geographical areas. Traditional and idiosyncratic design patterns, colour schemes and quality concepts are adapted

to modern consumer preferences without loss of cultural identity. This results in products uniquely rich in form and design that often appeal to affluent markets and enjoy great export potential.

37. The increasingly direct linkages between local areas and the global market also act as powerful forces for a greater decentralization of decision-making, putting growing pressure on centralized, top-down systems to delegate decision-making power from the national level to provinces and local governments and communities. Moreover, national policies and administrative decentralization often fail to solve local development problems, leading to the increasing empowerment of local and regional governments and communities within countries.

38. This increased decentralization of decision-making power brings the threat of increasing regional inequality, however. Peripheral areas facing comparatively more binding development constraints need institutions to help them realize their productive potential. The establishment of these institutions will, in turn, require a support infrastructure and customized producer services that the market often does not deliver. Correcting such market failures must also be a prime objective of domestic industrial development policies.

F. CONCLUSION: MATCHING GOOD DOMESTIC AND GLOBAL GOVERNANCE

39. The post-war system of global governance has given rise to unprecedented improvements in living standards. In recent years, however, it has come to face a number of increasingly serious challenges, many of which are related to growing economic and social disparities at the global

level. As with domestic governance systems, effective global governance needs to rest on a foundation of shared values, common vision and joint efforts. It also has to allow for diversity and rely on transparency, accountability and equity. The actors of the global governance system need to pool information, learning and skills, and share policies and practices on issues of common concern by means of protocols, conventions, informal agreements, partnerships and networks of institutions.

40. National policies and strategies need to be viewed in the context of this interplay between domestic and global governance. Only in this way can the far-reaching domestic implications of globalization be properly addressed. Major technological, economic and political changes in the international system require accommodation in the structure of global economic governance. Sustainable economic growth, accompanied by stability and equity, in a highly interdependent world economy, calls for institutional innovations to complement markets with information and knowledge on relevant policy experiences. These are the issues that will be analyzed in the remainder of this report, with reference to specific country and regional experiences.

II ELEMENTS OF EFFECTIVE POLICY FORMULATION AND IMPLEMENTATION

A. INTRODUCTION

41. As an unprecedented wave of policy reforms sweeps through developing countries and economies in transition, decision makers face the daunting challenge of designing better targeted, more focused and more effective policies which will not only ensure competitiveness but also achieve sustainable growth, improve living standards and eliminate poverty.

42. The opening up of economies to international competition does not of itself guarantee increased competitiveness of the domestic economy. In the extreme, it may simply eliminate domestic producers from the market place. Over-reliance on automatic mechanisms and market forces may be as detrimental to policy success as the belief in the omniscience of the state. Moreover, the concept of competitiveness, traditionally linked to effective real exchange rates, has become far more functional and multi-dimensional. Thus, a wide range of issues formerly looked on as essentially domestic or non-economic in nature are now recognized as influencing international competitiveness. They include, investment incentives, corporate taxation, technical and product standards, social security systems and labour markets, environmental controls, and different traditions of commercial and intellectual property law and corporate governance.

43. Nonetheless, the key determinant of industrial competitiveness remains productivity growth, and increasing manufacturing competitiveness is essentially dependent on improving the domestic factors of production. Many of these factors - investment in plant and equipment, education and training, knowledge and infrastructure - can be influenced by domestic policy, with positive or negative effects. And policies, in turn, can be directed at three separate levels of the economy - the industry-wide level, the sub-sectoral level, or at the enterprise level.

B. INDUSTRY-WIDE POLICIES

Industrial Governance

44. First and foremost, the successful development of industry depends on efficient and accountable management within a predictable and transparent policy framework - in other words, on good industrial governance. The factors influencing industrial governance range from macro-economic variables, such as efficient management of the balance of payments, public and private debt, and a stable currency, through the logistical tools of governance, such as rapid and easy access to reliable data and statistics on industry and a well educated and technically competent workforce, to participatory management of industrial development through consensus-building among all the economic and political actors involved.

45. Governance refers, in essence, to the manner in which power is exercised. Whilst the term originally gained currency in reference to sovereignty and hence the way in which national governments exercise power, it has since been broadened and disaggregated, as in the case of 'corporate governance'. Moreover, the spread of participatory government and market

economies through the developing world and economies in transition has expanded the categories of stakeholders involved in the exercise of power.

46. Thus, the term 'industrial governance' refers to the way in which political, economic and social groups involved directly or indirectly in industrial development exercise their power or influence. There is currently a broad consensus among the development community that good governance is characterized by participation, transparency, accountability, the rule of law, effectiveness and equity. In seeking to promote good governance as an instrument of industrial policy, one is concerned both with those groups within society in whom industrial power is vested and with the infrastructure through which they exercise that power. Whilst the concept is a broad one, it is possible to define some borders and to place it - as a policy instrument - within a tangible framework.

47. On one side of the equation are those groups within society exercising industrial power - governments, public institutions, professional associations, labour organizations, research institutions, etc. In order to make them more efficient and effective and to optimize their potential synergy, various measures can be taken, such as capacity-building at individual and institutional level; sensitization, by such means as workshops on comparative experiences in industrial policy or the impact of globalization and trade liberalization; and - a crucial element - the design and operationalization of permanent consultative mechanisms to promote a sustainable and concrete dialogue on policy formulation and implementation among all those groups involved in industrial development.

48. On the other side is the infrastructure which has to be set up to assist the relevant constituencies to formulate their ideas and to transform them into reality. This will usually include the establishment and maintenance of reliable statistical and other data bases to promote informed decision-making and to encourage investment; a secretariat to support the consultative mechanism; restructuring of ministries and institutions involved in industrial development and the provision of access to international information centres on industrial policies and practices.

Trade Policy

49. Governments seeking to promote industrial development in an opening economy must also carry out an inventory of their former interventions "on behalf of" industry, eliminating policy distortions - for example, by removing fiscal and financial subsidies which impede the smooth functioning of market forces. Trade policy remains one of the most important instruments for improving competitiveness at the industrial level. The worldwide trend towards liberalization and the introduction of global norms, such as the WTO rules, have encouraged the abandonment of policies of import substitution and infant-industry protection which were once so widespread among developing countries. Adherence to WTO rules, the removal of non-tariff barriers (NTBs) and the progressive lowering of tariffs are now a standard and fairly robust recipe for opening an economy up to competition from imports and for reducing previous anti-export bias. Yet, particularly among countries that have limited experience in dealing with the international trading system, the opening up of the economy must be accompanied by permissible market-support instruments, such as those offering temporary relief as industry is restructured.

Private Sector Development

50. Of vital importance to the success of industry as a whole is government's approach to private sector development. Governments throughout the developing world and in economies in transition have been re-aligning themselves as catalysts, facilitators and promoters of interaction with the private sector, with the ultimate aim of increasing economic output. In partnership with the private sector, governments provide support for firms to penetrate global markets, act to minimize red-tape while ensuring that enforcement is business-friendly and meets the needs of consumers. If international competitiveness is to be achieved, it falls to governments, for example, to ensure the flow of information, including relevant data for private decision making, and the diffusion of good ideas and outstanding examples of competitive entrepreneurial and corporate practice. Similarly, government agencies are usually best placed to act as a catalyst for the exchange of information with sub-sectoral institutions, with the aim of understanding the strengths and weaknesses of each subsector and assessing their overall competitive position.

51. In many developing countries and those with economies in transition, there is a need to establish permanent consultative mechanisms to ensure that leading decision-makers from all areas can meet on a regular basis to debate matters of mutual concern and to reach consensus. Although such mechanisms, for example, the Private Sector Forum and Private Sector Foundation recently established in Uganda, are paving the way to permanent dialogue with government, much remains to be done in ensuring that ideas are translated into reality. The issue of implementation of decisions reached through these mechanisms remains critical. This problem can be addressed by capacity-building and institutional strengthening within both the public (ministry of industry, for example) and private (chamber of industry, for example) sectors.

Environment

52. There is a growing consensus among policy makers, practitioners and industrialists that, in line with the broad sweep of current policy reforms, environmental policy should shift its emphasis from a reactive approach, which usually leads to a command and control regime, to a more proactive sustainable-development approach, designed to make markets work for the environment. Thus, developing countries and economies in transition are looking increasingly to market-based incentives to protect the environment, at least as complements to environmental regulatory frameworks.

53. Governments have traditionally sought to manage scarce environmental resources and assets through the use of command and control measures and direct control of quantities (rationing), whereas the market seeks to do this by setting prices which equate demand and supply. Both systems have various prerequisites which are rarely met in full measure. Consequently, there is a strong case for devising the right mix of policies to manage environmental resources and mitigate the negative environmental impact of economic activity. To discourage pollution, for example, governments have focused on setting standards for pollutant discharge and ambient environmental quality. Simultaneously, suasive strategies demonstrating the financial and environmental returns on adopting and promoting cleaner production and/or environmentally friendly technologies may also be adopted. However, empirical evidence suggests that this combination of control and command with suasive tools is not always sufficient to deal with the problems. Regulatory measures do not offer the polluter an economic stake, such as reducing production costs, in reducing emissions whilst demonstrating clean technologies is not, in itself,

sufficient to ensure that they are adopted. Thus, there is a need for a third type of intervention in the policy mix, that of economic incentives.

54. Economic incentives may be defined as instruments that affect the costs and benefits of alternative actions open to economic agents, with the effect of influencing behaviour in a way that is favourable to the environment. They either involve a transfer of funds between polluters and the community, such as pollution charges and taxes levied on emissions, ambient levels or products, or user charges for services, or the creation of markets for pollution emissions, such as tradeable permits and deposit refund schemes. The formulation of economic incentives as a basis for environmental protection is a complex task which must be undertaken on a case-by-case basis and the capability of countries and sectors to design and enforce incentives is likely to vary a great deal.

Policy Benchmarking

55. Benchmarking was originally developed as a management tool to help individual enterprises to identify their weaknesses and strengths in relation to competitors and thus help them to identify ways of improving their relative performance. The use of benchmarking techniques has gained increasing validity as nation states integrate into the global economy and the economic playing field becomes more level. In the previous paradigm, a vast array of customized political and economic devices, such as the granting of monopolies, subsidies and import licences, frustrated attempts at comparative analyses of impartial determinants of competitiveness such as labour costs and productivity, quality and capacity utilization. Benchmarking also moves beyond a passive ranking of a country, industry or enterprise to an active evaluation of the factors

determining competitive performance and, having determined why an enterprise, industry or country is competitive, it moves on to analyze how this has been achieved.

56. Competitiveness policy benchmarking is a relatively new tool applying a similar methodology to evaluate the effectiveness of policies and strategies used by individual countries and sub-regional groups in their efforts to become more competitive in the global marketplace. Thus, it provides governments with an effective tool to improve competitiveness at enterprise and sectoral levels. Moreover, for developing countries and economies in transition, such benchmarking affords an opportunity to avoid the conventional time lag of a decade or more in assimilating best practices in nearly all fields. It needs, however, to be undertaken in a methodical, systematic and organized way and in close consultation and collaboration with the private sector. Policy benchmarking also needs to be an ongoing exercise since the shelf life of information on policies and data on performance is inevitably rather short. In view of this, important economies of scale and scope can be gained through cooperation among developing countries, as the industrialized countries do within the OECD.

57. Policy benchmarking can also act as a tool for social policy and change. Despite their intrinsic value in allocating resources, markets are of little help in setting goals for society. In times of rapid change, societies need to articulate a sense of direction. The most successful countries are those that can define a vision on which policies are predicated. As developing countries and economies in transition endeavour to reformulate their own visions in an increasingly interdependent world economy, so reciprocal policy dialogue and learning in the policy fields gain in priority and, with them, the appropriateness of policy benchmarking.

C. SUBSECTOR-LEVEL POLICIES AND STRATEGIES

58. The history of industrial development provides several examples of successful targeting by government of industrial sub-sectors through the deliberate and subsidized creation of capacity. Although some scope still remains for deliberate capacity creation in the globalized economic environment of the late 1990s, many overt interventions are not permissible or, where they do not contravene international norms, would still prove unsustainable in the long run. On the contrary, in today's world it is import competition and the requirements of the international market which often constitute the most powerful inducements for the restructuring and competitive enhancement of a subsector.

59. Nonetheless, strictly temporary subsector support or relief is an acceptable policy in exchange for a credible and explicit commitment by dominant firms, including recently or about-to-be-privatized state-owned enterprises, to undertake significant restructuring measures. These include streamlining, cost cutting, hiving off intermediate activities and focusing on core business, with well defined, time-related productivity and profit targets. Moreover, it should not be overlooked that good industrial governance is a pre-requisite to the creation of a regime conducive to efficient restructuring and privatization decisions.

60. Where governments do decide to lend explicit support to a particular subsector, such sponsorship should be as a facilitator - working with the private sector to open communication channels and to establish an effective partnership aimed at diffusing best practice, benchmarking, supporting export strategies, and, ultimately, addressing the key determinants of competitiveness in partnership with industry. Some developing countries are, for example, moving into new fields

such as aerospace and biotechnology. To succeed, government needs to take a fairly pro-active stance. Many of these new subsectors are driven by university research and others by orders from the public sector. In most cases, significant scientific and technological resources have to be mobilized and returns are only visible in the long run. Success is characterized by a coordinated effort to achieve specific goals responding to concrete needs and - sooner or later - by passing the market test.

61. Encouraging the growth of small and medium enterprises (SMEs) is widely seen as an important element of industrial policy in many developing countries and economies in transition. Concerns that motivate government involvement in SME support programmes include the aims of creating jobs, improving welfare, alleviating poverty, raising incomes, and enhancing technical and entrepreneurial capacities. The emphasis on SMEs is also associated with the failure of the large scale manufacturing sector to meet many of these objectives. Moreover, in many segments of industry, there has been a move towards flexible systems of production, an emphasis on down-sizing and a recognition that SMEs are a key and not merely peripheral component of the production system.

62. An important strategy for SME development and for promoting manufacturing competitiveness is the promotion of regional and subsectoral clustering and networking. Clusters and networks are two complementary but distinct institutional settings. Industrial clusters are made up of geographically concentrated and sectorally specialized enterprises. Industrial networks link together geographically dispersed producers and other agents. In essence, clusters offer SMEs external economic advantages, including economies of scale and scope. Cooperation among agents within clusters and networks, through the sharing of information, resources,

knowledge and technical expertise, and other forms of joint action reduces transaction costs and further enhances competitiveness. It also accelerates learning and technical innovation.

63. The success of the region known as Third Italy and other European regions in the 1970s and 1980s exemplifies the power of collective efficiency focused on responding to the requirements of demanding customers. It has also contributed to shift policy debate towards more concern for, and better definition of, the role of regional and local government, and joint public/private sector initiatives. Moreover, the impact of public resources is increased when support is extended through working with groups of enterprises.

64. Firms belonging to the same industry often tend to cluster to take advantage of economies of agglomeration, including the presence of a dense network of suppliers and industrial service providers and to gain access to scarce infrastructure and telecommunications. Clustered firms can be supported on a more effective basis than those that are dispersed, particularly where markets are weak as in many developing countries. The success of such policies also depends on the presence of dynamic and effective local professional and academic institutions capable of mobilizing producers and serving as their advocates while directly - or through third parties - disseminating information, acting as training, technology and common facilities, and providing a bridge to the outside world. There is mounting evidence that inter-firm relations, set in motion by clustering and networking, offer a potential growth path that takes SMEs beyond a survival strategy to one of real, competitive and sustainable growth.

65. It is also clear that structures and forms of organization associated with clustering and networking are themselves continuously undergoing change and hence call for dynamic and

continuous monitoring and analysis. Thus, experiences from Indonesia and Brazil suggest that buyer-driven chains lead to more successful and dynamic clusters and networks than supplier-driven chains. This appears to lend credence to those critics who maintain that some types of traditional public support for SMEs, such as training, credit, raw materials and technology, are overly supply oriented and not sufficiently focused on demand. In contrast, customer-oriented assistance programmes involving, for example, promoting participation in trade fairs, public procurement and SME delivery contracts with large enterprises appear to be showing greater returns on the investment made.

66. Encouragingly, effective interventions to support SMEs aimed at fostering collective efficiency are multiplying in developing countries. While sometimes inspired by the success of industrial districts in advanced countries, other very interesting insights for policy are emerging from experiments in developing countries themselves. In terms of policy lessons, South-South channels seem to be at least as important as North-South channels for international learning and exchange of experiences.

D. ENTERPRISE-SPECIFIC POLICIES

67. In addition to general policies to help SMEs, applicable at both the subsectoral and enterprise levels, there are two specific sets of policies aimed at the enterprise level. The first comprises those that encourage producers to improve manufacturing practices, in particular by diffusing and encouraging adoption of total quality management and productivity programmes, supporting

research, development, design and engineering efforts though fiscal incentives, credit inducements and support infrastructure. In resource-scarce economies and those turning from inward-looking industrialization to outward-oriented strategies, the adoption by enterprises of continuous improvement, minimum waste of energy, materials and time, zero defects and other aspects of total quality management can result in significant and fairly rapid gains in efficiency. But productivity gains induced by quality and other improvement programmes eventually peter out and enterprises must also compete on the basis of product differentiation and innovation. In these circumstances, longer-term strategies involving, for example, incentives that stimulate producers to undertake R & D in-house or to contract out to university and other research centres are increasingly necessary.

68. The second set of enterprise-focused policies for increasing manufacturing competitiveness involves the strengthening of capacities by expanding physical and human capital. This is achieved by training and the build-up of industrial skills, an accelerated rate of capital accumulation and the dissemination of automation equipment and techniques. In newly open economies with idle capacity, existing resources must be used more efficiently and consequently retraining and skills acquisition should be a priority. In-house training can be encouraged by tax and other incentives to stimulate enterprises to invest in these activities. In developing countries it may also be necessary for government to offer extension services by training experts who are able to assess the training needs of individual enterprises and design programmes to meet their needs.

69. For many enterprises, an obstacle to improving competitiveness is the inability to keep up with the required pace of capital accumulation and modernization of ageing capital stock. Traditional financial incentives such as accelerated depreciation, long term loans and guarantee

funds, as well as newer mechanisms such as venture capital funds, help to increase the supply of credit and equity for investment. Leasing is another option for providing cash-strapped enterprises with rapid access to new equipment.

III CASE STUDIES OF INDUSTRIAL DEVELOPMENT POLICY

A. INTRODUCTION

70. This chapter provides several case studies illustrating particularly significant and relevant examples of successful industrial development policy initiatives taken by developing countries and countries with economies in transition. While these initiatives represent, for the most part, specific responses to the particular conditions prevailing in these countries and regions, they offer examples of approaches that may be emulated or adapted elsewhere to address similar challenges. Equally importantly, they reveal a number of more general insights which highlight the practical complexities of formulating and implementing appropriate industrial development policies and strategies.

B. LEAST DEVELOPED COUNTRIES (LDCs): PRINCIPAL INDUSTRIAL STRATEGY ISSUES

Recent industrial performance of LDCs

71. The circumstances under which a number of developing countries emerged as newly industrializing countries (NICs) in the 1970s and 1980s are different from the circumstances in which least developed countries (LDCs) are trying to achieve a higher degree of industrialization in the 1990s. As market forces and economic liberalization sweep across the globe new lessons

are being learned about competitive pressures for efficiency gains and about the need for a high degree of prudence and good governance in formulating and implementing industrial policies, respectively, in a liberalized market environment. The advantage of being a late-comer in the field of industrialization is that lessons of experience seem readily available to avoid false starts and wrong leads. Policy-makers in LDCs can take note of the warning signals of over-heated economies, crises of unprecedented magnitude stemming from the volatility of financial and capital markets, and the repercussions of liberalization going too far.

72. While the 1980s were a lost decade for most LDCs, the economic and industrial recovery of Africa that commenced in 1994/95 sparked a new sense of optimism about the African LDCs' potential to respond to new growth impulses. Most Asian LDCs are among the group of 12 LDCs that have experienced a real growth of more than 2 per cent per annum in *per capita* income over the period 1985-1995. If two countries facing special circumstances (Afghanistan and Yemen) are excluded, the average GDP growth rate for Asian LDCs for the period 1994-1996 is above 5 per cent.[3] The relative success of the Asian LDCs is built upon the growth of the manufacturing sector, at 9 per cent per annum during the 1990s in Bangladesh and Cambodia and 7 per cent per annum in the Lao People's Democratic Republic and the Maldives. Manufactured exports have also grown robustly. The export success is due largely to increased interaction with dynamic developing countries triggered by intra-regional trade and, more importantly, investment. Emerging trends across selected African LDCs also raise hopes for the achievement of a rapid economic transformation, using manufacturing as a dynamic force.

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[3] UNIDO, *Progress and Prospects for Industrial Development in Least Developed Countries (LDCs) - Towards the 21st Century,* Paper prepared for the Fourth LDC Ministerial Symposium, 26 November - 5 December 1997, Vienna, 1997.

73. Table III.1 presents data on the rates of growth of MVA and GDP in LDCs during 1985-1995. It is encouraging to note that out of 43 LDCs for which data are available:

- 31 countries enjoyed positive MVA growth during the period;
- Bhutan, Guinea, Lesotho, Maldives, Uganda and Vanuatu grew in excess of 7 per cent per annum;
- Bangladesh, Cambodia, Cape Verde, Nepal, Solomon Islands, and the United Republic of Tanzania experienced growth rates in excess of 4 per cent but lower than 7 per cent; and
- in a large number of LDCs the rate of growth of MVA was higher than the rate of growth of GDP, lending credence to the contention that the manufacturing sector acts as an engine of growth for the entire economy.

74. The data in Table III.1 also show the performance of the Asian LDCs to be clearly superior to that of the African ones. With the exception of the Solomon Islands and Yemen, MVA grew at a significantly faster rate than GDP in every Asian LDC. Clearly manufacturing has become the most dynamic sector in these economies. Since the overall GDP growth of the Asian LDCs is also significantly higher than that of other LDCs it may be argued that successful LDCs achieve rapid manufacturing sector growth, and that it is this sector's dynamism which determines the overall pace of economic progress.

Table III.1 Average annual growth of MVA and GDP in LDCs, 1985 - 1995 (Percentage change in constant 1990 prices)		
Country	*MVA*	*GDP*
Afghanistan	...	-6.2
Angola	-12.3	-0.6
Bangladesh	6.0	4.2
Benin	3.3	2.0
Bhutan	14.8	6.0
Burkina-Faso	1.9	1.9
Burundi	-0.2	1.7
Cambodia	6.9	3.0
Cape Verde	5.6	4.7
Central African Republic	2.9	1.9
Chad	-1.4	4.7
Comoros	2.4	1.1
Democratic Republic of the Congo	-0.8	-5.4
Djibouti	3.3	2.6
Equatorial Guinea	-1.4	2.2
Ethiopia and Eritrea	-0.8	1.4
Gambia	2.8	2.5
Guinea	7.5	4.8
Guinea-Bissau	-3.2	3.8
Haiti	-7.1	-1.9
Kiribati	0.3	4.6
Lao People's Democratic Republic	...	5.2
Lesotho	8.6	6.6
Liberia	3.4	2.0
Madagascar	0.8	1.0
Malawi	2.6	2.2

Maldives	10.7	8.8
Mali	3.8	3.1
Mauritania	2.8	3.5
Myanmar	1.6	1.8
Nepal	5.7	5.0
Niger	0.4	0.6
Rwanda	-10.9	-8.0
Samoa	-0.7	1.9
Sao Tomé & Principe	0.5	0.9
Sierra Leone	-4.7	-2.1
Solomon Islands	4.4	5.6
Somalia	1.7	-3.2
Sudan	0.6	2.7
Togo	-1.0	1.3
Tuvalu	...	2.9
Uganda	10.3	6.5
United Republic of Tanzania	4.2	4.2
Vanuatu	10.4	2.8
Yemen	1.1	3.4
Zambia	1.5	0.3
Least developed countries	0.6	1.0

Source: UNIDO database.

75. The performance of a few LDCs in Asia and Africa has been very impressive and stands as a model to be replicated in other LDCs. The LDCs that have achieved a high rate of economic growth have benefited from macroeconomic stability, high export and investment growth and low

inflation. Many of these LDCs started to rely less on primary commodity exports and more heavily on the manufacturing sector.

Constraints on industrial development in LDCs

76. A weak infrastructural base is generally recognized as a major constraint adversely affecting the efficiency of the industrial production system. Industrially more developed countries have provided substantive policy support for the creation of a strong infrastructural base, often with the active participation of the private sector. Infrastructural bottlenecks in LDCs constrain productivity gains in almost every aspect of industrial activity, from primary production to downstream processing and marketing.

77. A crucial constraint on productivity growth in LDCs has been inadequate human resource and entrepreneurial development. For example, students in tertiary educational institutions in LDCs still constitute only 3 per cent of the relevant age groups as against almost 50 per cent in the industrialized and 10 per cent in developing countries.[4] Moreover, the vocational and industrial training provided remains ineffective, partly due to problems associated with its design and implementation.

78. Another important constraint on productivity growth and entrepreneurial development in LDCs is a serious malfunctioning of the industrial financing system. Domestic savings, both household and corporate, remain very low and financial intermediation processes are becoming

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[4] UNIDO, *Promoting Competitiveness in Agro-Related Industries Through Capacity-Building*, Paper prepared for the Fourth LDC Ministerial Symposium, Vienna 26 November - 5 December 1997, Vienna 1997.

increasingly ineffective. Increases in real interest rates have not been accompanied by a rise in savings or an improvement in the efficiency of investment allocation. Financial liberalization has often been accompanied by a fall in financial intermediation. A deepening of the financial markets has not occurred.[5] Financial markets are highly segmented. The major financial institutions, especially the development finance institutions, have heavily infected portfolios, with the ratio of uncollectible debt to total advances often exceeding 50 per cent. This factor as well as the way prudential regulations are implemented has led to a virtually complete drying up of long-term credit to industrial investors in many LDCs. On the other hand, while informal financial institutions have grown, their links with the formal sector are tenuous and they do not provide finance for manufacturing and trading micro-enterprises. Enterprise upgrading and increased international competitiveness are not possible while the domestic industrial financial system is not effective and foreign concessional assistance is targeted at relieving balance of payments constraints and at social sectors, such as health and education. Equally important is the creation of an enabling environment for attracting foreign direct investment (FDI).

79. International constraints on productivity growth in LDCs are also significant. There has been a major improvement in commodity terms of trade during 1995/96 and the first half of 1997, which has had a significant impact on the improvement of the LDCs' macroeconomic performance since 1995. The outlook for commodity price movements in the medium term is less favourable, however, as generic technological developments are rapidly producing substitutes for traditional LDC exports such as sugar, cocoa and coconut. Uruguay Round trade liberalization has also not been of major benefit to most LDCs. The phasing out of the Multi Fibre Arrangement (MFA) is

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[5] UNIDO, *Industrial Development Global Report*, Vienna, 1997.

likely to enhance the competitiveness of large exporters such as India and China. The net benefits to LDCs will depend mainly on the interpretation by developed countries of the preferential treatment clauses of various components of the Uruguay Round Agreement. The 1997 World Trade Organization conference at which concessional pledges were made is an encouraging sign, but the total beneficial impact of these measures is likely to be small. Competitive pressure on many LDC labour- and natural resource-intensive products will increase.

80. In short, the major constraints on productivity growth are:

- the lack of a targeted industrial strategy;
- the absence of an institutional structure for enhancing entrepreneurship development in the private sector;
- inadequate industrial financing systems and the drying up of investment funds for both formal and informal enterprises; and
- the marginalization of LDCs within international trade, investment and technology transfer regimes.

Industrial development experiences of two successful LDCs: Bangladesh and Uganda

81. An assessment of the progress made by selected LDCs, which have succeeded in reaching and maintaining a relatively high level of industrial growth, is useful to identify viable avenues for accelerating the pace of industrial development in other LDCs and also helps to assess the potential for replicability. To this end, the preconditions that enabled Bangladesh and Uganda to climb the ladder of industrial development are analyzed below.

Bangladesh

82. The manufacturing sector recorded an average annual growth rate of 10 per cent during 1990-1996. The outstanding success was the phenomenal growth of the clothing industry which now accounts for almost 60 per cent of total export earnings, compared with 10 per cent a decade ago. The impressive growth has been helped by government policy initiatives undertaken since the mid-1980s. The government deregulated the industry, established bonded warehouses and export processing zones (EPZs) and exempted firms from taxes and customs duties. International subcontracting also allowed firms access to major foreign markets. However, the relatively simple technology and heavy use of unskilled labour has meant that Bangladesh can specialize in low-price standardized products only. Moreover, the heavy import dependence of the industry means that net export earnings usually amount to only a third of the gross foreign exchange earned.

83. In addition to clothing, other branches that recorded high growth rates include leather, glass, iron and steel, tobacco, chemicals, petroleum refining, food products and footwear. This growth took place without the creation of the economic enclaves that spurred the rapid growth of the garment industry. Since the early 1990s, leather products and processed fish have recorded robust export growth. Fish products now account for 10 per cent of export earnings and leather for 7 per cent.

84. This growth has been almost entirely domestically sourced, financed from corporate and household savings, financial sector borrowing and increasingly important remittances from non-resident workers. At the same time, foreign direct investment has been very small. Although there have been surges in portfolio investment they have been mainly of a speculative character.

Concessional assistance has been high, with annual disbursements averaging $1.68 billion during 1990-1996, but its impact on investment in the manufacturing sector has not been pronounced.

85. The growth of the manufacturing sector has mainly been a consequence of the success achieved by successive governments in maintaining macroeconomic stability as a precondition to spur investment growth. Inflation has been kept at about 5 per cent, and the real effective exchange rate did not fluctuate erratically. Government measures to stimulate private investment in the 1990s included:

- relieving private investment from bureaucratic control;
- liberalizing exchange controls for private manufacturing firms;
- initiating measures to end state ownership of industrial enterprises;
- reducing import controls and abolishing import permits;
- simplifying and reducing tariff rates;
- encouraging export promotion through EPZs;
- introducing duty drawback and special bonded warehouse schemes; and
- reducing corporate tax rates.

86. In response to these measures aimed at encouraging private sector development, investment and manufacturing output has grown in a sustained manner for almost a decade. Although the privatization programme has remained largely suspended, the policy accent has beenon enhancing the efficiency and profitability of state enterprises. It must be mentioned, however, that technological and human skills upgrading remains a challenge which will need to be adequately addressed in the years to come.

Uganda

87. In the early 1990s, Uganda emerged as the African "miracle" economy. The growth performance of Uganda's industries has been quite impressive since the launching of the Economic Recovery Programme in 1987, with the manufacturing sector registering an average annual growth of more than 10 per cent. Among the major branches, strong growth was experienced in food processing, soft drinks, sugar, paper and printing, garments, soap, and iron and steel products. However, within manufacturing there has been little structural change in output over the past two decades, and manufacturing continues to be dominated by the processing of locally produced agricultural commodities - indeed, food processing, tobacco and beverages, and textiles and clothing together account for more than 60 per cent of aggregate manufacturing output.

88. Uganda's industrial recovery has mainly been ascribed to a wide range of stabilization measures, an effective import substitution policy and substantial aid financing accounting for approximately 40 per cent of recurrent spending and 80 per cent of development expenditures. Foreign aid has thus played a particularly crucial role as a source of development finance. The emphasis of the structural adjustment programmes has been on fiscal and monetary policy changes, leading to a fall in the average annual inflation from 42 per cent in 1991/92 to about 3 per cent in 1995/96. Although foreign direct investment and private investment remained low, 70 per cent of private investment was directed towards the manufacturing sector, encouraged by an enabling industrial policy environment. Government measures to stimulate investment in manufacturing included:

- encouraging macroeconomic stability as a precondition for microeconomic efficiency;
- removing marketing monopolies;
- introducing public enterprise reform and a divestiture programme;
- accelerating the pace of privatization though consensus building among Ugandans on privatization; and
- moving to a flexible foreign exchange system.

89. While overall growth has been vigorous and quite diversified despite poor infrastructure and lack of human capital, the growth of manufactured exports has been very slow, still accounting for only 4 per cent of total export earnings.

Lessons of experience

90. There is no standard "model" of replication which guarantees success, but useful lessons can be learnt from the industrial development experiences of Bangladesh and Uganda. Key elements of the strategies employed by these countries can be partially replicated or adapted in the context of a specific national and sectoral environment. The following points in particular may be noted in this context:

- The experiences of Bangladesh and Uganda vividly illustrate that the provision of macroeconomic stability and the avoidance of major fluctuations in the exchange rate are a principal prerequisite to be provided by the government. Policy change must be gradual and deregulation of markets must not take place at the expense of policy coherence.

- It appears particularly from the experience of Bangladesh that the industrialization strategy can benefit from targeting potentially high growth industrial branches. This selective strategy must be flexible and capable of adjusting to changing circumstances and altering targets and priorities over the medium term.

- The importance of developing a close relationship between government and private enterprise is crucial. Both countries have made progress in this respect. The incentives that the government provides must be clearly linked to enterprise performance. Export performance is an effective indicator of the impact of an incentive system on enterprise competitiveness. To this end, both Bangladesh and Uganda continue to provide an array of incentives.

- The Ugandan case shows that foreign concessional assistance remains very important in the early phase of industrial development. It should, however, be effectively utilized to build domestic capacities for productivity enhancement.

- Cooperation with developing countries of the region is important. Both Bangladesh and Uganda have benefitted from regional cooperation, especially with India and Kenya respectively, who have provided important sources of financing and marketing.

- The building up of strategic partnerships between domestic and carefully selected foreign firms in key sectors is crucial. Much of the success achieved by Bangladesh in the clothing industries is due to the close collaboration of local firms with international suppliers and financiers. There are signs that such cooperation is also growing in Uganda, particularly in agro-industries.

Strategy for enhancing competitiveness through capacity-building

91. The principal dimensions of domestic capacity building include human, technological and institutional capacity building. The industrial development experiences of advanced countries and industrially more developed countries have attested to the fact that rapid industrial transformation was made possible primarily through the conversion of human capital into human capacities, which itself depended on the creation of an appropriate institutional framework.

92. Technological upgrading is not an automatic consequence of the opening up of the domestic economy to international markets. It requires the creation of technological absorption capacities and support systems. While the absorption of new technologies provides opportunities and powerful tools to achieve competitiveness, transformation mechanisms are required to translate the existing technological potential into actual economic benefits. It is here that industrial policy becomes increasingly relevant. Policy measures that influence domestic capacity building include, *inter alia*, an enabling environment, education and training, labour policies, entrepreneurial development, innovation, infrastructural development, and a suitable institutional framework.

93. The single most important requirement for overcoming constraints is the development of good governance by enhancing government capacity to formulate and implement an industrial vision in collaboration with the private sector, as well as the requisite investment and institutional strategy to facilitate productivity growth. Such an industrial vision must reflect a realistic

assessment of resources and opportunities. But it must also be ambitious in backing up private sector efforts through a radical transformation of existing structures, and in upgrading technological and entrepreneurial capabilities, especially at the firm level.

94. The purpose of upgrading firm-level efficiency is to convert comparative advantages into competitiveness. While comparative advantages are based on a country's resource endowment, competitiveness is determined by firm-centred initiatives. Given the limited resources of the LDCs, industrial strategy should be aimed at transforming a relatively small number of major firms, whose performance needs to be carefully monitored and incentives provided in strict accordance with an objective evaluation of their performance. East Asian governments have reaped rewards from deliberately creating 'performance crises' for major 'national champion' firms by setting ambitious targets for export and technology upgrading. Such a strategy could prove effective in many of the larger LDCs.

95. Strategic ambitions must not obscure the fact that technological learning is necessarily an incremental process. LDCs must build upon their existing technological base, which is mainly connected to the agro-related industries that typically account for more than 60 per cent of the value added generated by their manufacturing sectors. While agro-industries are resource- and/or labour-intensive or based on low wages, a low-technology industrial strategy is clearly insufficient for two principal reasons:

- First, long-term reliance in low-wage industrialization may be regarded as 'immiserising' industrialization, which leads to the export of productivity growth by reducing export prices, so that while export volumes rise, export earnings remain stagnant or subdued. It creates isolated industrial enclaves within the economy, and the productivity of the agricultural and rural sectors does not rise as a consequence of such industrial growth.

- Second, the labour-intensive branches in which LDCs have the highest dynamic comparative advantage are experiencing rapid technological upgrading. This is true of the clothing, textiles, footwear and leather products branches, where intensive applications of information technology have led to rapid changes in both production and marketing structures as well as increased competition from other developing countries. The relative inability to adopt a high-wage, high-technology strategy has trapped some successful LDC exporters at the lower price end of the international clothing markets; their products are usually bought (e.g. through buyback arrangements with parent companies) rather than sold, and much of the benefit of export growth is passed on to the foreign consumer. Technological upgrading in the food manufacturing industry is also both feasible and necessary. It is feasible because barriers to entry in biotechnology are low and is necessary because biotechnological applications are required for increasing food processing to reduce food insecurity and enhance rural non-farm employment.

96. By creating national capacities capable of complying with international quality and certification standards LDCs could overcome the barriers to global markets and thereby qualify themselves as global producers and suppliers. The key to enhanced competitiveness and productivity growth in the agro-related industries is the development of strategic alliances between LDC firms, their suppliers of technology and the retailer groups that purchase and market their output. Such strategic enterprise links are particularly important in the context of regional cooperation between developing countries and LDCs. There are attractive mutual

benefits to be gained by enterprise-level linkages leading to a lowering of the costs of developing countries' exports and the transfer of organizational systems and technological knowledge to LDCs. Capital market development in the developing countries can also make a significant contribution towards this end. A regional policy framework for industrial cooperation is also important for facilitating enterprise-level cooperation between developing countries and LDCs, especially because of the small size of many LDCs.

97. Equally important for technological upgrading, especially in agro-related industries, is integration between large enterprises and the small-scale and micro-enterprise sector. The adoption of mass customization structures of production and distribution have led many developing countries' firms to create close links with their small-scale suppliers, including micro-enterprises. This has led to accelerated export growth in clothing, footwear, surgical instruments, etc. in countries such as Brazil and Pakistan. Small-sized and micro-entrepreneurs have benefitted from being integrated into the production and distribution structures of larger firms, with the institutional links between them facilitating a rapid and continuous transfer of technological knowledge. This has led to enterprise upgrading.

98. Technological upgrading within the micro-enterprise sector also requires horizontal integration and encouragement of clustering. Support to micro-enterprises should typically be provided through systemic nodes, the major concern here being to enhance competitiveness. Micro-enterprises in African LDCs in particular have frequently failed to upgrade technologically.

99. Institutional capacity building for effective industrial financing is crucial. Many promising investment proposals fail to take off for lack of adequate finance. Industrial financing systems

could be focused on achieving micro-enterprise upgrading, and institutional links need to be forged between formal and informal financial institutions. Micro-enterprise development could be interlinked with the promotion of non-concessional financial flows and the forging of links between micro-enterprise clusters and major manufacturing enterprises. The rapid growth of rural towns and intermediate cities in many LDCs provides a natural focus for a layered industrial strategy, which deepens the manufacturing structures and uses finance as a mechanism for upgrading micro-enterprises technologically and organizationally. The restructuring of the micro-enterprise financing system is, thus, an urgent necessity.

100. An effective industrial strategy should, therefore, contain the following elements:

- It should be based on a realistic but ambitious industrial vision;
- Policies should not be 'locked in' but be seen as a learning process;
- The focus of industrial policy should be on the technological upgrading and entrepreneurial development of key firms, whose performance should be carefully monitored;
- Agro-industries could be prioritized and technological upgrading facilitated for increasing competitiveness and enhancing agricultural productivity;
- The construction and sustenance of strategic alliances among firms within the framework of regional cooperation should be encouraged; and
- Micro and small enterprises should be upgraded and linked to one another both horizontally and vertically.

C. SIGNIFICANT EXPERIENCES OF OTHER DEVELOPING COUNTRIES AND COUNTRIES WITH ECONOMIES IN TRANSITION

Brazil: Building up a Quality System in the Manufacturing Sector

101. At the beginning of the 1990s, the Brazilian government defined a new trade and industrial strategy to replace the import-substitution paradigm as a model of industrial development. In doing so, it opted for trade liberalization as the most effective instrument in changing the incentive regime for industry.

102. The transition towards a more open and competitive economy was helped by the introduction in 1990 of a new programme, the Brazilian Programme for Quality and Productivity (Programa Brasileiro de Qualidade e Produtividade, PBQP), to enhance the productivity of Brazilian firms and the quality of their outputs. While the new environment brought about by trade liberalization, combined with a recessionary economy, imposed strict discipline upon firms, PBQP helped to make both managers and workers aware of the importance of total quality management (TQM) and to reshape the internal organization of firms with the introduction of new management concepts and tools. In this sense, the PBQP was instrumental in ensuring that Brazilian firms responded effectively to the post-1990 opening of the economy.

103. The ability of Brazilian firms to overcome the simultaneous challenges of recession and import liberalization in the early 1990s reflected their commitment to cost-reducing and quality-enhancing measures. This led to firms giving up or subcontracting their least cost-efficient activities; reducing hierarchical levels in an attempt to improve intra-firm communication among

employees, and between employees and management; and introducing continuous improvement, quality circles, just-in-time (JIT) and other techniques of TQM and worker involvement so as to greatly reduce the high levels of waste and inefficiency that had previously characterized Brazilian industry.

104. The PBQP scheme is based on voluntary actions by the public and private sectors, and comprises both general and sectoral programmes. The former seek to motivate entrepreneurs and raise their level of awareness; disseminate information about the importance of improving the quality and productivity levels of all economic activities; and promote the development and diffusion of new managerial methods. In addition, there are 29 ongoing sectoral statewide programmes, involving 240 public and private institutions. The effectiveness of PBQP is based on large-scale training. By the end of 1994, some 17,000 managers and specialists known as quality multipliers had been trained.

105. The commitment to TQM is expressed in firms' adherence to international total quality standards, as codified in the International Standards Organization (ISO) 9000 series. Certification has become a major goal for industrial firms in Brazil, with the number of certificates issued increasing from 18 to 948 between 1990 and 1995. Meanwhile the number of producers adopting TQM standards more than doubled each year between 1991 and 1994. Although the pace has slowed in the meantime, a total of some 1,235 certificates had been issued and 1,159 units certified in 853 firms by mid-1996. This compared favorably with all other industrializing economies, with the possible exception of South Africa (1,627 certificates issued) but including Singapore (1,003) and Taiwan Province of China (1,060). According to the Brazilian Institute

of Metrology, there were 2,135 Brazilian enterprises with ISO 9000 certificates and 37 with ISO 14000 certificates by mid-1998.

106. Certification has also come to be seen by Brazilian entrepreneurs as an effective marketing device, a signal to clients, suppliers, creditors, shareholders and the public that Brazilian quality standards are close to international norms. A survey of 93 ISO 9000-certified producers undertaken by the National Industry Association (CNI) showed that only four enterprises had failed to register a positive impact from their certification efforts.

107. The ISO 9000-certified firms are concentrated mainly in the manufacturing sector, which accounts for 84 per cent of all certified units. Within manufacturing, the subsectors with the greatest number of certified units were electric equipment and electronic and optical products (22 per cent); basic chemicals, other chemical products and synthetic and artificial fibers (16 per cent); basic metals and manufactured metal products (12 per cent) and general machinery and equipment (10 per cent). The concentration of ISO 9000 certificates in the more technology-intensive subsectors - electronics, chemicals, metals and machinery - suggests both that the firms most capable of affording certification are concentrated in these subsectors and that the process of certification brings the greatest competitive gains to such firms.

108. Although certification tends to be spearheaded by larger firms, a recent comprehensive survey revealed that a considerable proportion of Brazil's SMEs have been engaged in TQM and have successfully attempted certification. It reflects a trend captured by numerous surveys of the widespread adoption by manufacturing firms of some form of quality and productivity enhancing programme, with a growing emphasis on training and upgrading of human resources.

109. An important side effect of the PBQP programme has been a growing recognition by producers that the impact of the introduction of total quality programmes is crucially dependent on the level of employees' basic cognitive skills and training. To encourage increased training, the government allows firms to deduct twice their training expenditures from their taxes. The training of industrial workers is also facilitated by the activities of the industry-led National Industrial Training Service (Serviço Nacional de Aprendizagem Industrial, SENAI), which has established a network of extension units for the provision of professional and technical training to the country's industrial workforce. At the end of 1995, SENAI operated 956 units, covering more than 3,000 municipalities, of which the majority were training facilities (329), centres for professional education (231) and relatively sophisticated and effective technology centers (24), in addition to 353 mobile units. Despite SENAI's efforts to respond to the shifting training requirements of industry and its reputation as a model training institution in Latin America, however, its coverage is still relatively narrow, with only a fraction of the industrial workforce having access to its training resources. In particular, the level of training provided to workers in SMEs and in less developed areas of the country is still relatively low.

China: Market-Based Instruments for Eco-efficiency

110. China enacted its first trial environmental legislation, the Environmental Protection Law (EPL) in 1979, which depended in large part on central planning and moral suasion. In the meantime, however, there has been a tendency towards combining command and control measures with economic incentives as environmental protection instruments. The former include ambient air and water quality standards, discharge standards, siting policies, closures, relocation and mergers. The latter, which have become especially attractive as China has moved towards

a market economy, comprise discharge permits, pollution levies, rewards for environmental achievements, price reform, environmental taxes and fines.

111. The original EPL specified that "in cases where the discharge of pollutants exceeds the limit set by the state, a fee shall be charged according to the quantities and concentration of the pollutants released". In an amendment to the EPL in 1982, four additional categories of penalties were introduced: enterprises that failed to meet effluent and emission standards for three consecutive years would face an increase of 5 per cent per year on effluent fees; old facilities that did not use treatment equipment and facilities built after 1979 that did not meet standards would be assessed for double fees; firms that delayed payments of fees for more than 20 days would face a fine of 0.1 per cent per day; and firms found guilty of false effluent and emission reporting or interference with government inspections would be penalized.

112. A discharge permit system for large enterprises was also introduced in 1982, with the discharge licenses specifying both the maximum permitted concentration of pollutants and the maximum permitted annual volume of wastewater discharge. The criteria for setting these limits vary from region to region. Some are based on ambient quality standards and others on the emissions *status quo* or technological capabilities. Large enterprises are required to pay fines for failures to meet permit conditions, which in turn are used to finance the government's environmental protection activities. Twenty percent of the revenue collected from the fees and 100 per cent from fines is used to support the operations of the Environmental Protection Bureaux (EPBs), while 80 per cent of the revenue generated by the fees is used to subsidize pollution control projects for enterprises that have paid into the system.

113. As designed, therefore, the system was a combination of incentives and deterrents. However, in reality, it has turned out to be more of a funding source for the EPBs than an incentive for reducing emissions. This is mainly due to the fact that the fees are smaller than pollution control costs and are not indexed for inflation. Moreover, many state owned enterprises can include fees under overhead costs and get compensation through tax deductions and price increases. Therefore they would rather pay fees than incur pollution control costs which can necessitate significant capital investments.

114. The introduction of the volume-based discharge permit system in 1982 also added further to the prevailing distortions in many regions where firms faced conflicting incentives on account of concentration-based fines on the one hand and mass-based fines for exceeding permit limits on the other. Conflicts have also arisen between pollution levies and the tax system. In addition, inadequate macroeconomic reforms, especially with respect to water pricing, have very often negated the incentive effects of pollution levies. Finally, monitoring and enforcement have also continued to pose a problem. Compliance is greatest in the case of new large-scale enterprises, while rural small and medium-sized industries feel less pressure to comply.

115. To address some of these problems, the Chinese National Environmental Protection Agency launched a two year study in 1994 to correct deficiencies in the pollution levy system and propose appropriate changes. The study assessed four main areas of concern: designing mass-flow levies based on marginal costs of pollution control; designing a revenue fund from pollution levies including institutional arrangements, technical assessment of loans and priorities for the use of funds; designing an information management system for calculating fees and maintaining billing

and receipt records; and addressing practical issues of implementation such as monitoring and enforcement.

116. The following general conclusions can be drawn from the Chinese experience with market-based instruments (MBIs):

- market based instruments must be introduced on a case-by-case basis; a blanket prescription is not possible;
- a pragmatic MBI strategy should start with a politically acceptable and publicly transparent scheme that combines existing command and control measures (such as discharge standards) with economic incentives (e.g. pollution charges or tradeable permits) and gradually evolve into a more efficient and effective system based on market incentives;
- a system based on economic incentives should be compatible with existing laws, legal sanctions and fines to avoid double penalties;
- for any system of MBIs to work effectively, it must be accompanied by a proper pricing of resources that reflects the true scarcity and opportunity cost of the resource; and
- the introduction of MBIs also has major implications for corporate management. Companies must develop accounting procedures as part of their environmental management systems, which enable them to allocate costs (such as pollution charges) and benefits (such as rebates) to appropriate units.

Slovenia: Fast Track to Convergence with the EU

117. Economic reform in the economies in transition in Central and Eastern Europe has progressed at a rapid pace since 1989. Most of them are very open with exports ranging from some 19 per cent of GDP in Poland to some 50 per cent or more in Hungary and Estonia. Western trade barriers against them have been dismantled and they have been granted most favoured nation status. They have also experienced a growing reliance on global capital markets along with FDI inflows and increasing intra-industry trade. Ten of the Central and Eastern European countries (Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia) have signed the so-called Europe Agreements which set the stage for accession negotiations to the EU. This historical commitment constitutes a unique fast track to institutional and policy convergence with an overwhelming impact on all spheres of governance in the candidate countries.

118. Future benefits have been weighed against major accession costs. The candidate countries are committed to full acceptance of the *acquis communautaire*, a body of EU law covering 80,000 pages - a non-negotiable condition. The combined investments required by the ten applicants in the environmental sector alone are estimated at 120-150 billion ECU over the next ten years. Formal accession negotiations with the first group of five countries (the Czech Republic, Estonia, Hungary, Poland and Slovenia) began in early 1998 with a view to possible, although unlikely, accession as early as 2002. For them, accession is expected to lay the foundations for sustainable long-term growth and economic convergence.

119. In the case of Slovenia, the preparation for accession implies an acceleration and widening of scope of a successful economic reform process underway since it gained independence in 1991. Its standard of living is already comparable to that of the poorer EU members. Even before the country's separation from the rest of Yugoslavia, Slovene managers traveled widely abroad and exported heavily to the West. *Per capita* exports were twice those of Yugoslavia.

120. Slovenia expects accession to accelerate the catching-up process with the developed European countries and stimulate an overall rise in competitiveness and standard of living. To this end, the country is taking the wide-ranging steps necessary to achieve all essential reforms and become a well-performing market economy so as to be in a position to join the EU by 2002. The government has adopted a comprehensive set of policies in the macroeconomic, microeconomic and structural reform areas. These include market liberalization; reform of the enterprise and financial sector; the development of transport, telecommunications and energy infrastructure; fiscal, tax and social security reform; human resources and labor market development; agricultural modernization; environmental regulation; regional and spatial development; reform of the public procurement process; and the introduction or amendment of intellectual property laws, company law, accountancy laws and consumer protection legislation.

121. The wide range of proposed measures notwithstanding, the cornerstone of the transition process is the reform of the enterprise sector. Although the process of the formal transfer of ownership and bank rehabilitation has for the most part been completed and major enterprise restructuring is well underway, on the whole, Slovenia's enterprise sector is still unprofitable. This includes a large number of enterprises yet to be restructured, privatized or liquidated, which still account for 10 per cent of the value added and nearly 18 per cent of total exports, and are

responsible for the bulk of the losses incurred by the enterprise sector. The already privatized enterprises, which account for almost three-fifths of total value added, also continue to make losses, albeit to a smaller extent.

122. The rate of effective protection for the manufacturing sector was reduced from 53 per cent in 1986 to 7 per cent in 1993. Although the collapse of the former Yugoslav market led to a successful shift towards foreign markets, it also caused manufacturing firms to adopt defensive cost-cutting measures. The share of industry in value added fell from 36.9 per cent of GDP in 1990 to 32.1 in 1995. Large scale manufacturing activities, often involving basic products, were particularly hard hit by the adjustment process, along with some of the more labor intensive subsectors although industrial growth has been positive since 1993. The fastest growing manufacturing industries are in transportation equipment, construction materials, electrical and optical equipment, chemicals, artificial fibers, beverages and tobacco.

123. These enterprise and financial sector reforms are to be complemented by price and competition liberalization, particularly through a competition policy aimed at dismantling state aid, merger control, restrictive agreements, state monopolies and public undertakings. This is expected to play a key role in releasing entrepreneurial energies, removing distortions and eliminating localized and systemic sources of inefficiency. In addition to the establishment of conducive framework conditions, emphasis is also being placed on acquiring best-practice production, organization and managerial techniques, improving efficiency in factor markets and increasing the share of investment in GDP to increase productivity and competitiveness. In this context, the government has initiated nine specific programmes aimed at fostering enterprise-based efforts towards the achievement of these objectives:

- quality, specialization, technological updating and research and development;
- SME development;
- networking;
- management education and training;
- export promotion;
- investment promotion and stimulation;
- diffusion of information technology;
- environmental protection; and
- harmonization of technical regulations.

124. Although these programmes are aimed at fostering structural adjustment, they are unlikely to succeed if issues relating to corporate governance are not properly addressed, particularly in the case of the newly privatized enterprises with a clear strategic investor/owner outlook. For these cases, additional measures are envisaged to stimulate a consolidation of ownership and a focusing of business strategy. These measures include an effective implementation of the Takeover Act, an accelerated development of the capital market and enforcement of property rights.

East Asia: Resuming Sustainable Industrial Development

125. The East Asian crisis of the late 1990s has not yet bottomed out. However, the huge social costs arising from it demand that the restoration of sustainable industrial development in the sub-

region be urgently addressed.[6] Because this is an unprecedented crisis in a group of countries that have recorded unprecedented achievements in the catching-up process in the past, there are no lessons from experience applicable to them directly. But this should not prevent an effort being made to analyze the policy challenges faced by them.

126. An important lesson learned from the crisis is that a set of fairly open economies can only achieve sustained growth rates far superior to those in the rest of the world if: (a) their world market shares record continuous growth and (b) their relative productivity and competitiveness also rises constantly at a rate higher than the rest of the world. Although the successes of the East Asian countries over the past few decades have been accompanied by a substantial structural transformation, limits have been reached in satisfying both conditions. This calls for new policy departures in a broad range of areas, including that of industrial development. The industrialization paradigm pursued so far requires reassessment, with greater emphasis on efficiency-driven investment processes.

127. In particular, the link between real and financial processes needs to be properly addressed. This requires a better tuned and more effective interplay between government, the financial sector and industrial enterprises in the process of resource allocation. Strong macroececonomic performance masked weaknesses in governance that failed to adjust to the rapidly expanding and opening economy. Investment was channeled to areas with progressively less solid risk-to-return ratios. Past growth trends enticed continued investment in capacity expansion of existing

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[6] Responses are already being articulated in the social area. For instance, ILO has launched a new Regional Programme to Support Large-scale Employment-intensive programmes in Asia and the Pacific with initial support from DANIDA, the Danish funding agency. Other multilateral agencies such as UNDP, the World Bank, the Asian Development Bank and UNIDO are also developing special programmes for the region.

industries while attention to rising constraints on profitability was diverted by a self-propelled investment momentum.

128. From a global perspective, the crisis illustrated clearly how a herd mentality among international investors seeking higher profits in a high-growth liberalized economic environment was succeeded by a herd mentality in search of safe havens. Similarly, the crisis also uncovered a breakdown of the relationship between risk assessment, rate of return on investment and gains in efficiency and competitiveness. From a domestic perspective, the crisis has revealed the need to examine several crucial issues of public and corporate governance in order to restore sound links between these variables. In doing so, it is important not to lose sight of the social and environmental dimensions, which will be significantly affected by efforts to engineer a quick recovery through conventional policy measures.

129. The crisis is also likely to have serious implications for industrial strategy. So far, manufacturing has constituted the backbone of the Asian NICs' catching up and human development strategies. The mainstream policy responses being prescribed to overcome the effects of the crisis give rise to serious concerns about the persistence of this trend, while alternatives to guarantee steady social progress as enjoyed in the past are not in sight.

130. The weakening of the macroeconomic environment in the East Asian countries will result in a corresponding deterioration in the conditions for a recovery in industrial growth in the short to medium term. The dynamics of international industrial competition had already led to downward pressures on the rate of return in a number of key subsectors, such as microelectronics and automobiles, even before the crisis struck. In addition, there was not enough coordination of

investment at the regional level to reap economies of specialization and scale. The achievement of efficiency gains on a regional scale now appears imperative to restore competitiveness, generate increased value added, strengthen domestic support industries and enhance intra-industry linkages in a sustainable manner.

131. Industrial and technological cooperation will need to be fostered. Also, addressing environmental sustainability has now become an urgent issue, as has the need to ensure that world standards of quality management are met. These circumstances pose the need to meet head-on the ensuing challenges in the areas of industrial restructuring, human and institutional competence building, business partnering and South-South cooperation in order to lay the foundations for a renewed long-term cycle of steady growth. Specifically, the following industry-based policy recommendations appear appropriate to support the recovery of sustainable economic growth and human development.

- Industrial Governance - A thorough assessment of the prevailing industry-related regulatory and decision-making systems is needed to enhance the existing diagnostic, institutional and policy design and implementation capabilities. A similar exercise is also called for to improve corporate governance.

- South-South Cooperation - In contrast to the past, South-South cooperation has become essentially business-driven, with governments acting as facilitators rather than prime movers. It also relies increasingly on sustained business partnerships and alliances rather than stand-alone operations without a follow-up. Rather than a device to settle trade imbalances, as in the past, it has become a means of taking advantage of complementary competitive strengths and accessing regional and extra-regional markets through effective enterprise-to-enterprise cooperation. Scenarios, policies and strategies for stimulating South-South cooperation in the face of intra- and inter-regional differences in resource endowment and industrial structure, shifts in relative competitiveness and market trends, and the need for greater coordination of industrial and technological learning efforts should be assessed and acted upon.

- Quality, Productivity and Environmental Management Standards in Industry - In view of the need to foster productivity upgrading, deal decisively with environmental degradation and cope with emerging trade barriers in the quality and environmental fields, an urgent assessment of rationalization and restructuring programmes aimed at attaining efficiency gains and improvements in environmental and quality management standards needs to be carried out.

- Foreign Direct Investment - Along with the problem of volatile speculative capital movements, the countries of the East Asian region face the prospect of a shift in foreign direct investment towards non-traded sectors of the economy. This represents an important potential source of instability as it may weaken the sustainability of the external equilibrium of the countries concerned, and needs to be addressed in advance through appropriate, coordinated policy approaches. Another important FDI-related issue is the relative openness of FDI-led international production networks in the region, given their implications for the development of intra-industry linkages, particularly through SME-based clusters and for the distribution of industrial and technological capability development within and across countries. Finally, the issue of outward FDI also needs to be addressed within and beyond the region in connection with South-South cooperation.[7]

D. REGIONAL INTEGRATION: A STEPPING STONE TOWARDS MULTILATERALISM

Introduction

132. Important new departures are taking place in subregional, regional and interregional integration processes in the developing world and among countries with economies in transition. State-driven trade integration processes are being superseded by enterprise-led investment, technology diffusion and networking processes as prime movers in the accommodation to new trends in the world economy. Key among these trends are the withdrawal of the state as manager and entrepreneur, the renewed pre-eminence of the innovative enterprise, major technological breakthroughs, the increasing narrowness of domestic markets and the globalization of FDI decisions. This section examines the experience of the two most vibrant South-South regional trade arrangements, ASEAN and MERCOSUR, in the context of the new challenges brought about by the emerging world economic order.

[7] The East Asian crisis is having a strong impact on South-South FDI. For example, Indonesian firms have retrenched their FDI activities in China.

Business-Driven Economic Integration

133. The development of cooperation among developing countries at the subregional, regional and interregional levels is increasingly enterprise-led. This is underlined by the expansion of intra-regional trade, which has not only increased significantly in value but also in the number of participating enterprises and scope of products and services traded.

134. The trend towards enterprise-driven South-South integration processes is also reflected in investment flows. Enterprises from first generation NICs (Hong Kong SAR, Taiwan Province of China, Republic of Korea and Singapore) are becoming more important investors in the ASEAN countries than Japanese enterprises. Cross-investments in MERCOSUR are also reaching unprecedented levels. For example Chile, associated with MERCOSUR through a Free Trade Agreement, has invested more than US$ 6 billion in Argentina alone since 1991.

135. Business diplomacy, as a complement of government diplomacy, is another dimension of the same phenomenon. It operates through the impact that systematic actions by businesspeople and their organizations have on policies and instruments of economic integration. In this context, it is also important to note that business-led economic integration is not merely accepted but actively encouraged by the governments of the countries concerned. The new regional trade arrangements epitomized by ASEAN and MERCOSUR seek to release business energies through policies designed to open up internal markets, foster structural change and enhance the ability of local entrepreneurs to compete in regional and global markets. They do so by coupling the removal of domestic barriers to the mobility of resources with the phasing-out of restrictions on the flow of goods and services across borders and the enactment of regulatory frameworks that ensure evenness of opportunity in business competition.

136. Significantly, the integration agreements of the 1990s are open to world markets and abide by the multilateral rules of the WTO. They are outward-looking because the economies of the participating countries are outward-looking and rest on the premise that openness to international competition in goods and services, given the right framework conditions, is one of the most powerful tools of trade policy and spurs of structural change. Indeed, one of the prime goals of these agreements is to attract investment, particularly that of global competitors, which can contribute to the mastery of technological and management best practices by their enterprises, and enhance the ability of these enterprises to operate in all markets. Against the dynamic background of major economic policy reform programs, the key parameter is not necessarily the size of the enterprise or its ownership structure, but its drive and ability to operate on a regional and global scale.

The Role of Business: MERCOSUR

137. Given the relative economic importance of its member countries (Argentina, Brazil, Paraguay and Uruguay) and the radical nature of the trade liberalization measures adopted over a short period of time (1991-1994), MERCOSUR epitomizes the new breed of South-South regional trade arrangement from which valuable lessons can be drawn. The development of MERCOSUR is premised on a strong political will among the four members and their associates to persist in their internal processes of economic reform and sustain the macroeconomic and sectoral conditions that enable enterprises, regardless of ownership, to compete in domestic, regional and extra-regional markets, especially those with the greatest purchasing power and growth potential.

138. Although businesspeople and investors are attracted first and foremost by the market of some 300 million consumers offered by MERCOSUR and its associated countries, they are not being offered a captive market, as indicated by the bloc's relatively low external tariff averaging 12 per cent and its openness to trade negotiations with the whole world. Most of the exceptions to the tariff liberalization schedule and the elimination of NTBs are scheduled to be eliminated before 2000. In addition, the radical processes of privatization and deregulation underway open up highly dynamic markets to both global players and regional investors in such fields as telecommunications, transport, energy, public services and infrastructure.

139. MERCOSUR has become a pole of attraction for efficient advanced industrial countries and developing-country competitors, such as the Republic of Korea and Malaysia, which invest and locate facilities in the bloc with a view to operating in the integrated market. In the automobile industry, for instance, some US$ 18 billion are earmarked to be invested by the key world players up to 2000, especially in Brazil and Argentina. A similar upward trend is observed in such subsectors as food, petrochemicals and chemicals.

140. Admittedly, much remains to be done to ensure full unrestricted reciprocal market access and to achieve a level playing field in every subsector. Policy legacies cast shades of unevenness, especially in services and government procurement. Neither are there clear rules on unfair competition. These constraints are being addressed by MERCOSUR organs, however, and, barring major macroeconomic disturbances, it is widely expected that MERCOSUR will develop into a full-fledged customs union. The signals sent to the markets when the Treaty of Asuncion was signed in March 1991 have been effectively pursued. A zero tariff for intra-MERCOSUR trade and a common external tariff were to be promptly attained. Today they are a reality, even

though the customs union still needs a few more years before it comes fully into force in all subsectors.

141. There is a growing awareness that, in line with government efforts to create and sustain an environment favorable to competition at the national and subregional levels, enterprises need to devote substantial effort to attaining acceptable levels of international competitiveness. Organizing and learning to compete is thus one of the greatest challenges faced by governments, businesses and all social actors in all member countries. The businesspeople of the sub-region have taken up the challenge. Since the signing of the Treaty of Asuncion, there has been intense activity by entrepreneurs to learn about the implications of MERCOSUR and, more importantly, to act upon such knowledge.

142. These initiatives reflect the interest of enterprises of all sorts, irrespective of size and ownership structure, in participating actively in MERCOSUR's future development. They cut across the whole gamut of economic activities. There is also awareness that SMEs have the greatest need for technical, information and other forms of support to enable them to adjust and take advantage of the enlarged market.

The Role of Business: ASEAN

143. Ever since ASEAN was founded in 1967 by Indonesia, Malaysia, the Philippines, Singapore and Thailand, the original member countries (except the Philippines) have enjoyed sustained real GDP growth rates of more than 6 per cent per year and real rates of GDP growth *per capita* of more than 4 per cent per year. From the late 1980s onwards, and prior to the current economic

crisis in the region, the growth rates achieved by ASEAN members had overtaken those of the first generation NICs to become the fastest in the world.

144. The success of the regional grouping was fueled by the domestic political stability and economic prosperity of the individual members. By the mid-1990s, after two decades of thriving growth, the development of intra-ASEAN linkages had accelerated, driven by private sector entrepreneurship and cooperation between the public and private sectors rather than by government-to-government policies.

145. Export processing zones (EPZs), free trade zones (FTZs) and 'bonded' factory sites played a key role in the development of the export-orientation of ASEAN - which took place along with a number of import-substitution policies. A tradition of largely unrestricted FDI operations originating in such zones gradually pervaded most of the host economies. Emphasis on FDI and export-orientation in the ASEAN countries consequently did not take place at the expense of, but were instrumental in, promoting national industrialization as the key engine of growth.

146. Cross-border trade among FTZs contributed greatly to the growth of intra-regional trade, much of which is intra-industry and takes place between subsidiaries of transnational corporations. In 1992, the grouping agreed to establish the ASEAN Free Trade Area (AFTA) within a 15 year period from 1 January 1993. A Common Effective Preferential Tariff (CEPT) scheme for manufactured products with at least 40 per cent ASEAN-wide content was established. The original goal was to reduce tariffs to a maximum of 20 per cent in five to eight years, and to a maximum of 5 per cent by 1 January 2008. NTBs were also to be phased out. The schedule was subsequently accelerated to reach full implementation by 2003, and some member nations have

unilaterally broadened the range of products on which to impose a maximum tariff of 5 per cent by 2000. The ASEAN Secretariat expects most intra-ASEAN traded items to be liberalized by that year, i.e. three years ahead of the WTO's deadline for developing countries. In addition, the implementation of Green Lane Systems was started on 1 January 1996, which will expedite the clearance of CEPT products through all ASEAN borders.

147. Despite the progress made in liberalizing intra-regional trade, the uniqueness of ASEAN lies in the fact that it is a grouping driven by private investment rather than trade. Within ASEAN, trade flows have tended to follow cross-border investment and technology transfer, rather than the other way around. Its genuine open regionalism is epitomized by the fact that the member countries' unilateral tariff and NTB reductions of the 1980s and early 1990s applied to all trading partners, not just to fellow ASEAN members.

148. At a Summit meeting in 1995, the ASEAN members agreed to establish the ASEAN Investment Area (AIA). This is designed to promote FDI inflows by transforming ASEAN into a single investment region through simpler and more transparent and harmonized codes and procedures. The steps to be taken in this direction include a comprehensive survey of FDI in the area, an expert group meeting on the promotion of FDI in the AIA, a round table on the formulation of a common strategic plan and a training course for ASEAN policy makers in the FDI field.

149. ASEAN's private sector embraces a dynamic mix of local and foreign enterprises which interact cooperatively as well as competitively with each other and with state-owned enterprises. Flexible adaptive strategies, such as alliance- and coalition-building, consultation, negotiation,

bargaining and compromise are key ingredients of such interaction. This flexible and pragmatic approach is underlined by the practice of allowing individual countries to opt out of particular cooperation schemes if they should so choose, thus proceeding on a lowest common denominator path to attain group-wide consensus.

150. ASEAN has instituted various mechanisms to further production specialization at the subregional level such as the ASEAN Industrial Projects (AIPs), Industrial Complementation (AIC) and Industrial Joint Ventures (AIJV) schemes The ASEAN Chamber of Commerce and Industry (ASEAN-CCI), comprising the national chambers of commerce and industry of the ASEAN member states, has played a key role in the enactment of these programmes. ASEAN-CCI sponsors various working groups (on such issues as industrial cooperation; trade; food, agriculture and forestry; and transport and communications) as well as regional and national industry and commodity clubs. It has also set up joint business councils with the private sector in ASEAN's major trading partners.

151. ASEAN's subregional growth areas (also called 'growth triangles' or 'polygons') are trans-border economic zones which comprise contiguous provinces or states of the member countries. They seek local development by promoting the intraregional flow of resources rather than just trade in goods and services. They are not discriminatory towards the rest of the world. Governments play a facilitating or catalytic role by undertaking joint infrastructure development projects, coordinating investment policies and sponsoring business missions to third countries.

152. Their key is the exploitation of actual or potential resource complementarities to foster growth and efficiency as well as competitiveness on a global scale. Private investors find in them

the necessary framework conditions to embark upon projects and networks of projects anchored on matching resource endowments across borders, involving the movement of capital, labour, skills, technology and information. Because these projects take advantage of externalities that spill over across national boundaries, the market alone fails to guide the seizing of the ensuing opportunities. What matters most in the growth areas is the expansion of resources and the growth of future output rather than static efficiency gains from using existing resources. This is attained by means of specialization and relocation of economic activity, leading to intra-industry trade as a key to improve efficiency in resource use and promote growth.

IV MULTILATERAL COOPERATION AGENDA FOR SUSTAINABLE INDUSTRIAL DEVELOPMENT

A. SUMMARY AND CONCLUSIONS

153. Globalization forces developing countries and economies in transition to look again at their policies and strategies on industrial development. These are increasingly based on market-led and outward-looking approaches which involve the creation of a dynamic framework within which market institutions can function effectively, enterprises can learn to do business, create alliances and cooperate, and in which the appropriate skills and capabilities are nurtured. The increasing integration of markets for capital, technology, goods and services on a worldwide scale calls for matching changes in domestic decision-making and regulatory and incentive systems, as well as in the institutions of global governance. At the same time, the need to relate economic growth to social equity and environmental sustainability has led to a new, multidimensional approach to development. The present document addresses that new approach from the perspective of industrialisation.

154. The document reviews a wide range of policies and strategies for sustainable industrial development in developing countries and economies in transition. They are based on recent experiences and on state-of-the-art knowledge. While the lessons of practical experience from other countries can be invaluable, it is also recognized that these countries have very diverse political, economic and social histories and, as such, are at varying levels of industrial

development. Thus, there is no one common recipe for industrial success. Rather, each individual country will need a mix of customized strategies together with more generic policies.

155. One key concern of the document is to provide insights into ensuring that industrial development is both compatible with domestic pressures for economic growth, social progress and environmental sustainability and with the move to globalization and the emergence of global standards of regulation and competition.

156. A broad variety of themes are covered, ranging from industry-wide policies, such as industrial governance, competitiveness policy and policy benchmarking, through sub-sector strategies such as the promotion of SMEs, to enterprise-level policies, as well as broader issues, such as industry's role in protecting the environment. These policy approaches are supported by specific country and regional experiences, which include the removal of constraints on industrial growth in the least developed countries (LDCs), the building up of a nation-wide quality system for manufacturing in Brazil, the introduction of market-based incentives for eco-efficiency in China, Slovenia's handling of accession to the European Union, a return to sustainable industrial development in East Asia and the facilitation of business-driven economic integration in ASEAN and MERCOSUR.

157. Among the lessons learnt, the following merit particular attention:

- Important challenges still face developing countries and economies in transition in the field of industrial governance, competitiveness, the establishment of effective market institutions and compliance with global mandatory and voluntary standards.

- Developing countries and countries with economies in transition need to define, adopt and put into practice new policy initiatives aimed at more accountable, transparent and effective systems for allocating resources to industrial development, raising efficiency, promoting competition and reducing transaction costs, whilst at the same time creating conditions conducive to compliance with global governance and regulation.

- There is a need for better understanding of and reciprocal learning on institutional and policy changes at the domestic and global levels. This can be achieved by increased information flows and experience-sharing. It is particularly relevant in areas where a new consensus is emerging between donors and developing countries and economies in transition on policies and strategies for industrial development commensurate with worldwide trends towards more open and competitive markets with due attention to equity considerations.

158. This emerging consensus extends to:

- Strengthening and raising the effectiveness of domestic industrial decision-making and of industry-related regulatory and incentive systems;
- Encouraging greater competitiveness;
- Capacity-building for benchmarking policy effectiveness;
- Promoting demand- and network-oriented SME strategies;
- Establishing quality systems at the national level;
- Removing constraints on industrial growth and avoiding the marginalisation of the LDCs;

- Introducing market-based incentives for eco-efficiency;
- Promoting regional integration through private sector interaction; and
- Urgently restoring sustainable industrial development in East Asia

B. MULTILATERAL ASSISTANCE AND THE ROLE OF UNIDO

159. The new developments and ensuing challenges and opportunities posed by current trends need to be addressed boldly and effectively. These include the emergence of global regulation and governance with the spread of rule-based practices and international standards of competitiveness, the looming marginalization of sub-Saharan African countries from the global economy, the East Asian crisis and the promotion of social development and environmental protection through sustainable industrial development. Conceptual and operational building blocks for a new consensus on sustainable industrial development are emerging. Now, a multilateral cooperation agenda for industrial development needs to be formulated and implemented to reconcile domestic development needs with those stemming from the globalization process.

160. Within this overall context and based on its mandate, UNIDO is in the process of finalizing a new portfolio of integrated services to address the needs of developing and transition economies. To this end, multidisciplinary fields of expertise are mobilized to deliver integrated services which are assessed in terms of their measurable impact on the three dimensions of sustainable industrial development - a competitive economy, a sound environment and productive employment.

161. This new approach specifies and translates into action the Business Plan on the Future Role and Functions of UNIDO approved at the seventh session of the General Conference of UNIDO in December 1997.

162. The UNIDO Business Plan focuses on two areas:

- strengthening of industrial capacities; and
- cleaner and sustainable industrial development

163. In addressing these two areas, UNIDO is called upon to give special emphasis to activities in support of least developed countries in particular in Africa (with special attention to the regional and sub-regional level), in support of agro-based and agro-related industries, and in support of small and medium enterprises and their integration into national industrial structures.

164. The table below lists the new UNIDO integrated services - which are subject to some further finetuning - and relates them to both the Organization's Business Plan and the primary dimensions of sustainable industrial development.

Table IV.1 UNIDO integrated services

Main Areas of UNIDO Business Plan	Primary sustainable industrial development dimension targeted	UNIDO Integrated Services
Strengthening of industrial capacities	**Competitive economy**	• Industrial Governance • Industrial Export Capacity Building • Industrial Information Networking • International Industrial Partnerships • Quality and Certification for Industrial Competitiveness
Cleaner and sustainable industrial development	**Sound environment**	• Cleaner Industry and Environment • Efficient Energy Development
Areas of concentration (least developed countries; agro-industries; small and medium enterprises)	**Productive employment**	• Agro-related Industrial Development • Local Industrial Development • Women Entrepreneurship Development

165. Each integrated service and its components reflect UNIDO's dual role as a global forum and as a provider of technical cooperation. In its global forum role, UNIDO monitors state-of-the-art

advances in industrialization with potential to enhance the ability of recipient countries to pursue sustainable industrial development. In its capacity as a provider of technical cooperation, UNIDO assists in building up capacities in public and private sector institutions to formulate and implement industrial policies and strategies, and to deliver services to industry, particularly to small and medium-sized enterprises. In all cases, UNIDO's integrated services will be customized to specific country needs and requirements in response to the level, prospects and constraints of industrial development.

Emphasis on support to African countries

166. African countries are in special need of receiving multilateral assistance to strengthen and upgrade their domestic capacities for effective industrial policy formulation and implementation. UNIDO therefore places special emphasis on support programmes for African countries which constitute the largest recipient region of UNIDO assistance. With a view to supporting these countries within a coherent framework, in October 1996 UNIDO launched the African Alliance for Industrialization (AAI - hereafter referred to as Alliance) which responds to the objectives of the United Nations New Agenda for the Development of Africa in the 1990s (UN-NADAF) and complements the United Nations Special Initiative for Africa (UNSIA).

167. The Alliance is specifically aimed at enhancing foreign direct investment flows to African countries, strenghtening the linkages between industry and agriculture, and increasing the value added of domestic industrial processing activities. In May 1997, the Alliance Plan of Action - a comprehensive framework for industrial development in Africa - was adopted by the Organization

of African Unity (OAU) and subsequently endorsed by the General Assembly in its resolution 52/208. Specific modalities for its implementation were drawn up and its operational and management bodies are currently being established.

168. The fundamental underlying principle of the Alliance is national ownership. African Governments themselves take the lead in priority-setting and decision-making at all stages of the process. Therefore, in 1998 a key activity under the Alliance involves establishing Industrial Partnership Councils as the national machinery charged with implementing the Alliance Plan of Action. These Councils comprise representatives of both the public and the private sector so as to ensure effective private sector led industrial development.

169. In response to General Assembly resolution 52/208, UNIDO will organize in early 1999 a donors conference for the funding of industrial development projects in African countries. Consultations are underway with the African Development Bank (ADB) regarding the modalities of this donors conference. A technical preparatory meeting will be held by UNIDO in August 1998 while the ADB will convene an inter-agency preparatory meeting in September 1998 to discuss the roles of the various organizations involved.

Cooperation with the private sector

170. The present document has emphasized the need for developing countries and countries with economies in transition to create effective partnerships and collaborative mechanisms between the public and the private sector in formulating and implementing industrial policies. It is equally important for the United Nations organizations to enhance their cooperation with the private sector.

This involves several dimensions ranging from private sector representatives in an advisory role to private sector organizations acting as project counterparts and finally the mobilization of funds from private sector sources. UNIDO established in early 1998 a new Branch on Private Sector Development to strenghen its role in supporting capacity-building in private sector organizations in the developing world. Also, the UNIDO International Business Advisory Council convened its second annual conference in Casablanca in October 1997 and provided advice on the future orientation of specific support programmes in areas related to the mandate of the Organization.

UN system cooperation

171. Coordination and cooperation with other multilateral development cooperation agencies, in particular within the United Nations system, will be ensured and actively promoted by UNIDO in the framework of their respective mandates. Specifically, in March 1998, UNIDO concluded an agreement with UNCTAD in which the complementary roles of the two organizations in the field of investment promotion, and the related area of small and medium enterprise development were spelled out. This landmark agreement in the UN system signals a new spirit of cooperation and will be followed by similar agreements with other UN organizations. There is a distinct need for the UN system to join forces for the benefit of recipient countries - a process which is also exemplified by the development of joint programming mechanisms such as the United Nations Development Assistance Framework.